Supreme Court, U.S.
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No. 01-

IN THE

Supreme Court of the United States

ALLEN C. CHAMBERLIN and
MARTHA L. CHAMBERLIN,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. United States Tax Court procedure requires the Commissioner and the taxpayer, before resorting to formal pre-trial discovery, to confer for the purpose of narrowing the issues and stipulating as fully as possible all undisputed facts, documents and evidentiary matter. The parties in the present case observed this requirement, entering into a 35 page Stipulation of Fact accompanied by numerous documentary exhibits. During the trial 1,000 or more pages of these exhibits were admitted into evidence by the Tax Court. At the same time the court, stating many times that the exhibits speak for themselves, allowed petitioner only a day and a half rather than the requested three days to give testimony regarding 15 taxable years. Thereafter, inexplicably, the Tax Court failed to consider any of the documentary evidence on one of the important issues in the case, whether or not petitioner was engaged in the trade or business of owning and financing a pharmaceutical manufacturing plant and leasing the plant to his 80% owned corporation. The Second Circuit affirmed the Tax Court, apparently without considering *any* of the evidence on this same issue, reaching the baffling conclusion that petitioner was not engaged in the trade or business of manufacturing pharmaceuticals, a trade or business petitioner's 80% owned corporation was engaged in, but which petitioner himself had never claimed to be engaged in.

The question presented is whether the Tax Court was justified in limiting the time given petitioner for oral testimony on the ground that the exhibits speak for themselves, and then, in its opinion, ignoring the exhibits pertaining to the trade or business issue.

2. The United States Court of Appeals for the Second Circuit disposed of the appeal by Summary Order rather than regular published opinion. Although this Summary Order was replete with, if not solely based on, glaring errors, the court nevertheless denied a motion requesting a panel rehearing and further denied a motion seeking correction of the Summary Order.

The question presented is whether the appellate court abused its discretion in handling the appeal, and exercised its appellate jurisdiction in a manner inconsistent with Article III of the U.S. Constitution.

LIST OF PARTIES

The caption contains the names of all the parties. Petitioner Martha L. Chamberlin is named as a party because she and her husband, petitioner Allen C. Chamberlin, filed joint tax returns for the years in question.

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Petitioners respectfully petition for a writ of certiorari to review the Summary Order of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

The Tax Court's Memorandum Opinion (per Mary Ann Cohen, J. (then Chief Judge pursuant to biennial designation by the court) allowing in part and disallowing in part the deficiency asserted by the Commissioner (Appendix ("Pet. App.") 8a is reported unofficially at T.C. Memo 2000-050. The Second Circuit's Summary Order (per Dennis Jacobs, J., joined by Fred I. Parker and Sonia Sotomayor, JJ.) affirming (Pet. App. 1a) was not published, nor were the Court of Appeal's subsequent orders denying a panel rehearing (Pet. App. 36a) and denying a motion to correct the opinion (Pet. App. 38a).

STATEMENT OF JURISDICTION

The Court of Appeals filed its Summary Order July 9, 2001 and denied rehearing on October 22, 2001. Petitioners invoke this Court's jurisdiction under § 7482(a) of the Internal Revenue of 1986 (IRC) and 28 U.S.C. § 1254(1).

STATUTES AND COURT RULES INVOLVED

The relevant provisions of Rule 70 and 91, Rules of Practice and Procedure, United States Tax Court and § 7458 IRC are reprinted in the Appendix at 39a.

STATEMENT OF THE CASE

In 1977 petitioner Allen C. Chamberlin, then an orthopedic surgeon, became interested in the generic pharmaceutical industry after a chance meeting with a promoter who was seeking capital for a company the promoter had recently taken control of named Pharmacare, Inc. Pharmacare manufactured and packaged generic pharmaceuticals and other products in Largo, Florida. Relying on the promoter's misrepresentations and false pretenses, petitioner made loans totaling $1,255,400 and helped raise capital from third parties on a commission basis.

Pharmacare was forced into bankruptcy in 1980 and the loans were never repaid. In the course of the bankruptcy petitioner himself acquired the Largo, Florida plant and leased these facilities to the Chamberlin Corporation, 80% owned by him. Petitioner continued to lend his own money and guarantee loans by commercial lenders, hoping to staunch the flow of red ink and keep the Largo, Florida pharmaceutical manufacturing plant, which he now owned, operating.

In 1981 petitioner personally guaranteed business loans totaling $1,426,352. Thereafter, with these loans seriously in default, petitioner was forced to mortgage his personal residence in Connecticut to secure a $1,750,000 loan from another lender, which was used to repay the 1981 loans and honor his guarantees.

In 1983 and 1984 he arranged three further loans totaling $2,800,000 in order to keep his pharmaceutical plant operating, again personally guaranteeing the loans and securing them by mortgages on his home. His $412,596 pension plan was also pledged to secure loans. He resigned from the hospital he had been affiliated with and eventually devoted himself virtually full time to this business venture, while his income from the practice of medicine dropped to 0.

Petitioner's efforts to carry out his ambitious plans finally unraveled in a business bankruptcy in 1984 and a personal bankruptcy in 1985. Petitioner's losses by the time of his bankruptcy exceeded $6,000,000. According to the Tax Court opinion petitioner was indiscriminately claiming a deduction for the entire $6,000,000, regardless of the composition of that figure. But no such deduction is allowed by the Internal Revenue Code, and petitioner at no time claimed such a deduction. In fact out of economic losses totaling $6,032,052 petitioner claimed tax losses of only $2,681,752 — a $1,255,400 theft loss and a $1,426,352 bad debt loss. This was in stark contrast to the taxpayer in *Brenner v. Commissioner*, 62 T.C. 878 (1974), one of the cases cited by the Tax Court. In that case the taxpayer tried to parlay a $200,000 economic loss into a $669,666 tax loss.

The Tax Court Memorandum Opinion found for petitioner on several issues, including the theft loss, based on the promoter's misrepresentations and false pretenses, and allowed in part the loss resulting from petitioner's personal guarantees. However, the court found that petitioner was not engaged in trade or business as a developer or promoter, making no mention of petitioner's alternative claim to trade or business status as lessor of the Florida pharmaceutical manufacturing plant. As a result, the loss from his guarantees was a long-term capital loss and did not create a business net operating loss which could be carried to other years and fully deducted.

On appeal the Second Circuit affirmed by Summary Order and subsequently denied a motion for a panel rehearing and a motion to correct errors in the opinion. This Petition for Certiorari is commenced within 90 days from the denial on October 22, 2001 of petitioner's request for a panel rehearing. The United States Tax Court had jurisdiction over the proceedings below pursuant to § 7442 IRC, and the Second Circuit Court of Appeals had jurisdiction to review the decision of the United States Tax Court pursuant to § 7482(a) IRC.

REASONS FOR GRANTING THE WRIT

The petition should be granted for two reasons. *First*, the procedure followed by the Tax Court entailed a departure from accepted Tax Court practice and deprived petitioner of the fair hearing to which he was entitled by § 7458 of the Internal Revenue Code of 1986 (IRC). *Second*, the Second Circuit exercised appellate jurisdiction in an incorrect manner by failing to give this case, involving tax deductions of $2,681,752, adequate consideration, and by failing to issue an appropriate judicial decision as required by Section 1, Article III of the United States Constitution.

I. The Court Should Exercise Its Supervisory Power To Ensure That The Tax Court Follows Its Own Rules Governing Trials And That Tax Court Trials Are Conducted In A Manner That Is Fair To Both Sides. The Tax Court Departed From This Standard By Allowing Petitioner Only Half The Time Requested For Trial On The Ground That Petitioner's Exhibits Would Adequately Carry Petitioner's Burden Of Proof, And Then Failing To Consider The Exhibits On The Important Trade Or Business Issue

The Tax Court Rules of Practice and Procedure call on the parties to conduct voluntary discovery by informal consultations, communications, etc., before resorting to compulsory procedures such as depositions, document production and interrogatories. Rule 70(a). Formal discovery techniques are intended to be used as aids to the parties cooperative pre-trial efforts. Rule 91(a). Informal discovery rules encourage — in fact mandate — the parties to reach common ground regarding as many factual issues as possible and regarding the authenticity of as many documents and other potential exhibits as possible. The parties must then incorporate their agreement in a stipulation, which is submitted to the court at or before trial. Rule 91(c). This

procedure has long been ensconsed in Tax Court tradition, as this quotation from a 1974 case shows:

> For many years the bedrock of Tax Court practice has been the stipulation process, now embodied in Rule 91. Essential to that process is the voluntary exchange of necessary facts, documents, and other data between the parties as an aid to the more expeditious trial of cases as well as for settlement purposes. (Fn. omitted). The recently adopted discovery procedures were not intended in any way to weaken the stipulation process. See Rule 91(a)(2). *Branerton Corporation v. Commissioner*, 61 T.C. 691 (1974)

To enforce this rule the Tax Court may refuse to allow formal pre-trial discovery prior to completion of the stipulation process. *Boso v. Commissioner*, T.C. Memo 1995-228. And all evidence contained in the parties' stipulations has the same force as if presented during a trial. *Borchers v. Commissioner*, 98 T.C. 182 (1990). The parties' stipulations are binding on taxpayer and Commissioner alike. *Korangy v. Commissioner*, T.C. Memo 1988-2, affirmed, 893 F.2d 69 (4th Cir. 1990); *Louisiana Land and Exploration Co. v. Commissioner*, 90 T.C. No. 38 (1988) and *Sennett v. Commissioner*, 69 T.C. 694 (1978). And for failure to comply with Tax Court Rule 91 and undertake negotiations and a good faith effort to compile a suitable stipulation, the Tax Court may order a dismissal. *Levy v. Commissioner*, 87 T.C. No. 49 and *Larsen v. Commissioner*, 765 F.2d 939 (9th Cir. 1985).

But in the present case this stipulation process, the "jewel in the crown" of Tax Court procedure, was unceremoniously ignored by the court itself in its opinion, with the unfortunate result that both the Tax Court and the Court of Appeals opinions were based on misperceptions. The Tax Court

mistook the entity involved and the Court of Appeals mistook the trade or business involved. To correct these egregious errors a remand should be ordered, requiring the Tax Court to consider the parties' extensive Stipulation of Fact in accordance with the accepted and usual course of proceedings in that court.

A. The Trade Or Business Issue.

Section 162(a) of the Internal Revenue Code allows a deduction for the ". . . ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . ." According to this Court the concept of a "trade or business" as found in § 162 is a ". . . common sense concept . . ." and a resolution of the issue ". . . requires an examination of the facts of each case . . ." *Commissioner v. Groetzinger*, 480 U.S. 23 (1987).

Courts have long recognized that an activity intended to protect and preserve a taxpayer's investments does not qualify as a "trade or business". This was the square holding of *Higgins v. Commissioner*, 312 U.S. 212 (1941), in which the Court observed:

> The petitioner merely kept records and collected interest and dividends from his securities, through managerial attention for his investment.

P. 218.

Investors, no matter how actively involved in overseeing their portfolios, are excluded because the focus is not on the extent of the taxpayer's activity but on the nature of the taxpayer's reward. *Deputy v. du Pont*, 308 U.S. 488 (1940). A taxpayer seeking only the typical investor's reward of interest, dividends or appreciation in the value of corporate stock is not engaged in a trade or business.

On the other hand, the activity of leasing real property *may* be considered a trade or business. *Whipple v. Commissioner*, 373 U.S. 193 (1962). In fact owning and leasing real property as petitioner did has repeatedly been denominated a trade or business. *Whipple*, *supra*; *Commissioner v. Moffat*, 373 F.2d 844 (3d Cir. 1967); *Maloney v. Spencer*, 172 F.2d 638 (9th Cir. 1949); *Reiner v. United States*, 222 F.2d 770 (7th Cir. 1955); *Lagreide v. Commissioner*, 23 T.C. 508 (1954) and *Jephson v. Commissioner*, 37 B.T.A. 1117 (1938) and see *Walter v. Dunlap*, 368 F.2d 118, 120 (3d Cir. 1966).

B. The Tax Court Ignored The Stipulations And Exhibits.

1. The Stipulation of Fact and the exhibits allowed in evidence and referred to in Petitioner's Proposed Findings of Fact, but ignored by the Tax Court, showed that petitioner's only reward came in the form of rental income from his factory - supporting petitioner's claim that owning, leasing and financing his pharmaceutical manufacturing plant was a trade or business.

2. The Stipulation of Fact and the exhibits allowed in evidence and referred to in Petitioner's Proposed Findings of Fact, but ignored by the Tax Court, also showed that while the bankruptcy proceeding was awaiting resolution petitioner personally assumed responsibility for plant maintenance, agreeing to have the machinery "turned over" periodically to keep it in good working order. Petitioner also undertook to indemnify the trustee in bankruptcy personally for any resulting damage to the machinery and equipment, and the plant's utilities were changed to petitioner's name and the taxpayer personally paid the utility bills. Exhibits showed that petitioner personally paid the plant's property taxes during this period. And in 1981 petitioner assumed a $430,000 debt owed to a Florida bank for funds previously loaned to Pharmacare, Inc., and secured this obligation with his own assets, giving a lien on his retirement savings of $412,596.

3. The Stipulation of Fact and the exhibits allowed in evidence and referred to in Petitioner's Proposed Findings of Fact, but ignored by the Tax Court, showed that in connection with his interest in the Largo, Florida pharmaceutical manufacturing plant petitioner consulted a law firm licensed to practice law in New York and Florida and personally incurred legal bills of $52,589. Surprisingly in light of the Tax Court's determination that petitioner himself was not engaged in a trade or business, these legal bills of petitioner actually exceeded the legal bills of Chamberlin Corporation, the corporation he had invested in, which the Tax Court ruled *was* engaged in a trade or business. The Chamberlin Corporations's legal bills came to $26,079, less than half the legal bills of petitioner individually, although according to the Tax Court petitioner was only an "investor".

4. The Stipulation of Fact and the exhibits allowed in evidence and referred to in Petitioner's Proposed Findings of Fact, but ignored by the Tax Court, showed that in 1980 petitioner had organized a joint venture with another individual to acquire the stock *or assets* of bankrupt Pharmacare. Finally, in 1981 petitioner did acquire the assets of Pharmacare, not the stock. This crucial fact — found to be true by the Tax Court in its findings of fact but later simply ignored in the court's opinion — distinguishes the present case from the typical "investor" case in which the individual claiming to be the proprietor of a business has actually interposed a corporate entity between himself and the trade or business in question. *Bell v. C.I.R.*, 200 F.3d 545 (8th Cir. 2000). Petitioner in the present case, far from owning only shares of stock, actually owned a pharmaceutical manufacturing plant in fee simple, in his juridical capacity as an individual. A great many individuals who own pharmaceutical plants — assuming there are a great many such — would have to be buttonholed before one could be found who did not consider himself to be engaged in business,

or who would not be considered by the courts to be engaged in business. This would be all the more true if the individual, like petitioner here, gave personal guarantees and pledged his own home as well as his retirement savings in order to raise money to keep the pharmaceutical plant running. As petitioner emphasized in the Tax Court, the fact that a taxpayer has mortgaged his other property to secure loans for his corporation supports a finding that he himself is engaged in business. This is true even if the taxpayer is not engaged in the separate and distinct business of lending money. *Maloney v. Spencer*, 172 F.2d 638 (9th Cir. 1949). The *Maloney* case was cited with approval in footnote 11 in *Whipple v. Commissioner*, 373 U.S. 193 (1963).

5. The Stipulation of Fact and the exhibits allowed in evidence and referred to in Petitioner's Proposed Findings of Fact, but ignored by the Tax Court, showed that during this period, beginning with the involuntary petition filed against Pharmacare by its creditors on June 12, 1980 and ending with the disposal of the bulk of Pharmacare's assets on September 18, 1981 by bankruptcy sale to the petitioner, a number of solutions to the financial problems of the bankrupt Largo, Florida pharmaceutical manufacturing plant were discussed. These included acquisition of the plant by a joint venture, acquisition by Chamberlin Corporation, or in the alternative, acquisition by petitioner individually. The restructuring finally agreed upon by the trustee in bankruptcy and the creditors (including petitioner) involved a series of steps. The rights previously acquired by Chamberlin Corporation from the trustee in bankruptcy to purchase the Largo, Florida pharmaceutical plant were assigned to the petitioner individually. Thereafter the trustee in bankruptcy conveyed title to the plant to petitioner by deed dated September 18, 1981. In return petitioner personally assumed a $572,046 first mortgage on the property held by the Community Bank and personally gave Chamberlin Corporation a purchase money second mortgage in the

amount of $183,800. By the terms of the purchase money mortgage petitioner personally took responsibility for payment of property taxes on the pharmaceutical manufacturing plant and for keeping the building fully insured.

6. The Stipulation of Fact and the exhibits allowed in evidence and referred to in Petitioner's Proposed Findings of Fact, but ignored by the Tax Court, showed that on September 22, 1981, the Chicago Title Insurance Company issued title insurance policy No. 10 1163 01000001 in the amount of $750,000 to petitioner individually as the owner in fee simple of the pharmaceutical plant's land and buildings. To secure this insurance petitioner had to sign a Mechanic's Lien Affidavit representing that there were no liens against his land and/or his building for work done during the preceding 90 days. Again, a typical investor in the stock of a pharmaceutical company would not feel the need to obtain title insurance in his or her own name on a plant being used to manufacture pharmaceuticals.

7. The Stipulation of Fact and the exhibits allowed in evidence and referred to in Petitioner's Proposed Findings of Fact, but ignored by the Tax Court, showed that Pharmacare's 200 or more pieces of machinery and equipment as well as the company's patents and formulas, were also transferred to petitioner individually. Petitioner then conveyed a lien on this equipment to secure performance of his guarantee of Chamberlin Corporation's indebtedness to the finance company. And petitioner had to sign an undertaking that he personally had not retained any broker in connection with the re-financing of the pharmaceutical plant and that if any broker became entitled to a commission, he personally would hold the finance company harmless.

8. The Stipulation of Fact and the exhibits allowed in evidence and referred to in Petitioner's Proposed Findings

of Fact, but ignored by the Tax Court, showed that petitioner did not nonchalantly sign the numerous documents involved in this case, including guarantees, mortgages, promissory notes and assumptions of real property taxes and other liabilities. These documents had been prepared with the assistance of the petitioner's counsel and were not just pieces of paper sporting the petitioner's signature. Nor was petitioner being excessively cautious in obtaining title insurance on the pharmaceutical manufacturing plant he had just purchased. Exhibits showed that at the time these events were taking place in Florida, petitioner's personal residence in Connecticut was being appraised at $3,00,000. In signing these documents petitioner was placing his $3,000,000 home at risk in order to provide funds to operate the pharmaceutical manufacturing plant he owned. In fact his signature on these documents did later cost petitioner his home, as well as his retirement savings. His home was sold in 1985 to pay petitioner's debts when petitioner's efforts to promote generic drugs finally ended in bankruptcy, and his retirement savings were lost as well.

9. The Stipulation of Fact and the exhibits allowed in evidence and referred to in Petitioner's Proposed Findings of Fact, but ignored by the Tax Court, showed that following petitioner's purchase of the pharmaceutical manufacturing plant and the plant's machinery and equipment, etc., petitioner leased these facilities to Chamberlin Corporation. Although petitioner was primarily liable for taxes, insurance and upkeep, the lessee was required to pay these bills by the terms of the lease. However, the Chamberlin Corporation, the lessee, was losing several hundred thousand dollars a year and virtually all bills were paid by petitioner himself. Petitioner's lawyers had prepared the lease and while it was in terms a 'net, net, net' lease, the factory was demised for only 6 months at a time, with no option to renew. The exhibits showed that the short term of the lease and other restrictions

on the lessee's use of the plant were intended to protect petitioner's $2,000,000 manufacturing plant from Food and Drug Administration decertification. Decertification would result in a catastrophic loss in value. The Tax Court has taken the position that a triple net lease may constitute a "trade or business" under § 162 IRC, the relevant section in this case, even if not an "*active* trade or business" under the differently-worded § 355 IRC. *King v. Commissioner*, 55 T.C. 677 (1971). In any event the lease was not just a "net, net, net" lease standing alone, in view of the multiplicity of petitioner's other activities involving the pharmaceutical manufacturing plant. Exhibits showed that in addition to his many personal guarantees of loans to keep the plant running, petitioner, in leasing his pharmaceutical manufacturing plant along with the machinery and equipment, reserved to himself many important property rights in the Largo, Florida plant. Perhaps most significant, as noted the lease was for a term of only six months. The lessee was not given an option to renew — mutual assent of the parties was required for renewal. Any assignment or subletting required petitioner's approval, as did all on-premises advertising, signage and insurance matters. Petitioner reserved the right to cancel the lease on 60 days written notice (except during the winter months) in the event he decided to remodel, alter, demolish, lease long-term or sell part or all of the demised premises. And the lease, admitted in evidence, specified that the factory was to be used to manufacture pharmaceuticals and for no other purpose.

Consequently many crucial exhibits which had been included in the parties stipulation and allowed in evidence were swept under the rug by the Tax Court's opinion. This occurred in spite of many rulings from the bench and comments by the Commissioner's counsel during the trial regarding the importance of the parties' stipulation, as can be seen from the following:

The Court:

That's a nice size stipulation. Why do you need three days for trial, Mr. Hansen?

Mr. Hansen:

Your Honor, we have seven — perhaps seven or eight witnesses, and the subject of the tax controversy covers three bankruptcies and an out-of-court restructuring and a period of some 15 years. So it's a fairly complicated factual situation.

The Court:

That's why we have the stipulation.

(The Tax Court then allowed petitioner 1&1/2 days for the trial) (parentheses added).

* * *

The Court:

And I don't want to spend time just going over the documents that are stipulated.

Tr. 93.

* * *

The Court:

That's another reason I think it's cumulative, because some of those exhibits relating to other charges against Mr. Vavlitis are now in the record, which is also why I think your witnesses, Mr. Crowell specifically, are cumulative and I'm not waiting for them.

Tr. 163.

* * *

The Court:

> This document is in evidence. Let's not have the witness keep reading from documents that are in evidence.

Tr. 174. (As the Transcript shows the witness was merely referring to the document, not reading it.) (Parenthesis added).

* * *

The Court:

> And what's the point of — I mean, I've asked you not to waste time having him recapitulate documents that are in evidence. The evidence is here as to what he did. The sequence of the documents explains themselves. You have a lot of territory to over and very (sic) little (sic) time to do it in.

Tr. 175- 176. (sics added).

* * *

The Court:

> That letter is in evidence. Why are we wasting this time?

Tr. 178.

* * *

The Court:

> . . . either it's admissible as past recollection recorded, in which event this testimony about what the document says is superfluous. . . .

Tr. 198.

* * *

The Court:

> The purpose of receiving it in evidence was to *prevent his testifying about it.*

Tr. 199 (emphasis added).

* * *

Mr.Aletta:

> Your Honor, objection for a moment. This is wasting time here for the Court. We know what — the exhibit is already in evidence. *We can all read and know what's on the exhibit . . .*

Tr. 219 (emphasis added).

All the stipulated exhibits on the trade or business issue having been ignored, the lone, brief mention of petitioner's ownership of the pharmaceutical factory, found in the Tax Court's Findings of Fact, not its Opinion, was inaccurate. Thus the Findings of Fact include the following (Pet. App. 12a):

> "The Chamberlin Corp. purchased the inventory, intangible property, personal property, and equipment of Pharmacare from the trustee in bankruptcy for $200,000 and then immediately (actually this was 6 weeks later) transferred ownership to petitioner. On September 18, 1981, in a three-party agreement, petitioner purchased the Largo facility from the Pharmacare trustee in bankruptcy by giving the Chamberlin Corp. a $183,800 promissory note and assuming $572,046 of debt secured by the property. The Chamberlin Corp. then paid $177,954 of Pharmacare debt on behalf of the trustee and $4,077 of transfer expenses.

> Petitioner rented the Largo facility back to The Chamberlin Corp. from 1981 until 1984." ("Back to" is not correct here and gives an erroneous "sale-leaseback" impression — actually the land and buildings were never owned by Chamberlin Corporation, they were sold directly to the petitioner by the Pharmacare trustee) (parentheses added).

The Tax Court's Opinion, however, does not focus any attention on this finding of fact. It assumes that the petitioner's corporation, not petitioner himself, owned the pharmaceutical manufacturing plant. Disregarding in toto the exhibits which the Tax Court rules required the parties to assemble, the Tax Court cited only one meaningful precedent. This precedent could hardly have been less in point since it involved a taxpayer whose *corporation* owned the facilities in question. *Fleischaker v. Commissioner*, T.C. Memo 1999-427. Thus the court's reliance on this case was misplaced. True it involved a taxpayer who, like petitioner here, foresaw opportunities in the health care sector of the economy. But despite this superficial similarity *Fleischaker* was not a "horse of the same color" — in fact it was a different animal altogether. Since the facilities were owned by the taxpayer's corporation, not by the taxpayer himself, investor tests and standards, not the entirely different trade or business tests and standards were implicated in *Fleischaker*.

The prominent role petitioner stipulations averredly play in Tax Court practice proved to be a will-o'-the-wisp for petitioner. And the Tax Court's across-the-board refusal to consider and discuss the parties' stipulation undoubtedly contributed to the baffling number of errors in the Second Circuit's Summary Order, discussed below. The case should be remanded to the Tax Court for proper consideration of all the evidence, including the Stipulation of Fact and exhibits.

According to Tax Court rules Stipulations of Fact and exhibits introduced at trial are supposed to be an integral part of the proof submitted by litigants. However, the court departed from this procedural norm in the case at bar.

II. The Handling Of Petitioner's Appeal Constituted An Abuse Of Judicial Power Vested In Appellate Courts By Section 1, Article III Of The U.S. Constitution

The appeal below was resolved by Summary Order of the United States Court of Appeals for the Second Circuit. By its terms this order may not be published in the Federal Reporter and may not, generally, be cited as precedent. The pros and cons of such unpublished opinions, a practice that obviously assists the appellate courts in coping with their heavy work load, have received extensive attention in recent years.

Those in favor of the practice argue that unpublished opinions can successfully convey to the parties and their counsel the court's decision and the reasons for it. And these proponents argue that no better solution has been offered for coping with growing dockets than to relieve judges who have decided a case from the time-consuming job of writing a publishable, citatable opinion, particularly if a settled area of law is involved. *Hart v. Masanari*, 266 F.3d 1155 (9th Cir. 2001).

Those opposed to the practice maintain that court selection of decisions that are to be given *stare decisis* effect involves an unconstitutional exercise of quasi-legislative power by the courts. *Anastasoff v. United States*, 223 F.3d 89 (8th Cir. 2000), vacated on grounds of mootness, 235 F.3d 1054 (8th Cir. 2000). According to the first opinion in *Anastasoff* this discretionary power would eventually give the courts too much leeway in deciding cases, as more and more law became non-binding.

The Anastasoff opinion also expressed concern that a tolerant attitude toward disregarding precedent might undermine the role of the courts in curbing abuses of executive power. *See also Andrews v. Neer*, 253 F.3d 1052 (8th Cir. 2001) and *Williams v. Dallas Area Rapid Transit*, 256 F.3d 260 (5th Cir. 2001).

Petitioner leaves this problem to wiser heads - the solution, if any, will undoubtedly require the combined efforts of all three branches of the government. In the meantime, the debate itself raises the possibility that an ostensibly non-binding opinion could, on appeal or on consideration en banc, suddenly coil and strike with *stare decisis* force, as happened in *Anastasoff*. Alternatively, non-binding opinions could produce intracircuit conflicts as happened in *Williams v. Dallas Area Rapid Transit*, transforming an important sector of the law into a minefield of uncertainty for lawyers and their clients.

In view of these problems and uncertainties this Court should not hesitate to exercise its supervisory powers, when necessary, to oversee the quality of such unpublished dispositions. (According to *Hart v. Masanari*, p. 1177, *supra*, these dispositions accounted for 80% of the cases decided by the courts of appeal nationwide as of the year 2000). In this regard it is difficult to see how the summary disposition of the present case by the appellate panel measured up to decision-making norms. Virtually none of the statements in the Summary Order were correct, as witness the following:

1. The Court in its Summary Order dated July 9, 2001 stated on page 5 ". . . much of Petitioner's case was devoted to evidence purporting to establish a theft loss stemming from misrepresentations that induced Petitioner into investing in one of the bankrupt corporations — evidence that had little or no impact on the amount of income taxes and penalties owed to the IRS." (Parenthetically, this evidence did not merely "purport" to establish a theft loss. The Tax Court ruled that petitioner had in fact been the victim of larceny by false pretenses and was entitled to a $1.2 million theft loss.) In its

opinion the Second Circuit thus ruled that petitioner's counsel had mistakenly wasted the trial time given him by the Tax Court in a senseless attempt to establish a $1.2 million theft loss. Nothing could be further from the truth. In so finding the Court accepted at face value statements made on behalf of the Commissioner, statements that find no support whatsoever in the record. Petitioner categorically refuted this argument, raised for the first time by the Commissioner on appeal and completely contrary to the position taken by the Commissioner during the trial.

The fact of the matter is that the Tax Court might have applied the general rule regarding the timing of bad debt losses in bankruptcy and found that petitioner's loss of $1.4 million stemming from petitioner's previously-mentioned personal guarantees occurred in 1984, when the debtor, Chamberlin Corporation, went bankrupt. In that event the $1.2 million theft loss itself would have been central to petitioner's whole case because of the tax rules governing bankruptcies. Section 1398(g) and (i) IRC. Without the crucial $1.2 million theft loss, in addition to petitioner's $1.4 million bad debt loss, no carryover loss would have been available to petitioner on termination of petitioner's bankruptcy estate. For this reason the general rule regarding the timing of bad debt losses in bankruptcy situations had to be, and was, taken into account by petitioner. The Tax Court in its opinion seriously considered applying the general rule, but eventually determined that recognition of the loss should not occur at the time of the debtor's bankruptcy in 1984, but rather in 1985 when efforts were abandoned to reorganize the debtor. Had the Tax Court followed the general rule on the timing of bad debt losses in bankruptcy, and had petitioner's counsel *not* tried to establish the theft loss, petitioner's counsel would now be reproached with malpractice for *not* trying to establish the theft loss rather than, as has happened, reproached with malpractice for *trying* to establish it.

And regardless of its interdependency with the $1.4 million loss resulting from petitioner's personal guarantees, the $1.2 million theft loss also forestalled a potential tax liability of more than $100,000 which otherwise would have been owed by petitioner as debtor in possession as a result of the sale of petitioner's residence by petitioner's bankruptcy estate.

2. The Court also noted on page 4 of its Summary Order: "And Petitioner's claim that he controlled his pharmaceutical business as a landlord (thereby converting his nonbusiness shareholder losses into business debt) is inadequately supported by the record." But petitioner's claim to business status was not based on control or absence of control over the manufacturing processes carried on in his factory. Rather, his claim to business status was based on being in the trade or business of owning, leasing and financing a factory, as was the case in *Whipple v. Commissioner*, 373 U.S. 193 (1963).

Again, the appellate court did not have the benefit of the Tax Court's thoughts — which is petitioner's principal objection on appeal — since the Tax Court failed to delve into the record and make its own views known. But there is a superabundance of evidence in the record to support the claim that petitioner's many activities as the owner/lessor/financier of the pharmaceutical manufacturing plant rose to the level of a trade or business. As noted, petitioner owned in fee simple the factory used to manufacture generic drugs; he could cancel the 6 month lease held by The Chamberlin Corporation on 60 days notice (except during the winter months), giving petitioner the power to evict his 80% owned corporation from the factory and operate it as a sole proprietorship or otherwise if he chose. This power over corporate assets involved far greater control both in degree and kind than investors possess. Or petitioner could raise the rent every 6 months if he chose — he had been advised by his lawyer as to the exact procedure to

follow in order to raise the rent. And petitioner held all the purse strings — he alone could set the terms and conditions of the loans he personally guaranteed, and aside from funds provided by commercial lenders it was always petitioner's money that kept the plant operating, not the corporation's. The record is clear that the Chamberlin Corporation had little or no borrowing power, compiling losses of $297,000 in 1983 and $760,000 in 1984 and having only a 6 month lease on its manufacturing facilities. Only petitioner's $3,000,000 home and $412,596 pension plan induced creditors to lend. Any claim that petitioner personally guaranteed loans of over 4 million dollars just to keep his corporation running rather than to keep his pharmaceutical manufacturing plant running simply defies credulity. Exhibits showed his corporation was worth at most $250,000, making his 80% interest worth at most $200,000, while the pharmaceutical manufacturing plant he owned was worth $2,000,000 or more. By claiming petitioner was only an investor the Commissioner has managed to make a $200,000 tail wag a $2,000,000 dog. Every step of the way the record supports the view that petitioner's position as landlord was, as petitioner asserted in the Tax Court, the "vital center" of petitioner's venture into the pharmaceutical business.

3. The Summary Order also states that "Inasmuch as the record indicates that taxpayer used the Freedom Federal funds to purchase another pharmaceutical company, we conclude that the creation of the debt was dominantly motivated by his nonbusiness interest." The record shows that less than one-fifth of the Freedom Funds were used to purchase the other pharmaceutical company.

4. The Second Circuit opinion also stated: "Petitioner has made no showing of what determinative evidence he was unable to introduce." Forgetting for the moment that petitioner had requested 3 days for the trial after explaining the complicated nature of the many facts he had to prove,

only to be given 1 1/2 days, this assertion by the court is contrary to the record, as the following excerpts show:

> Q (taxpayer's counsel) And what I was after was just a general summation of the amount of money that you invested in all these businesses that we've been talking about during that period, 1978 through 1985.
>
> A (taxpayer) Would you like me to add them up?
>
> Q (taxpayer's counsel) Yes, certainly.
>
> The Court: No, we don't have time for that. Your time is up, Mr. Hansen. We're going over the same territory we have gone over for a day-and-a-half now. Tr. 286.

Regarding these very loans the Tax Court opinion then inconsistently states:

> Petitioner had failed to provide sufficient evidence showing that the $1,300,000 of remaining principal was reloaned or contributed to either corporation or to show how much funding, if any, he provided to the Chamberlin Corp. for the asset purchases or startup costs. There is no contemporaneous corroboration of his generalized testimony.

And the statement that there is no "contemporaneous corroboration" of petitioner's testimony is particularly baffling — over 20 pages of documentary evidence attached to the parties Stipulation of Facts confirmed petitioners's testimony.

These grievous errors should be corrected in fairness to petitioner. The record shows that a tax liability of over half-a-million dollars is involved. If the decision is wrong because based on an apocryphal version of the facts, in effect it unjustly imposes a sentence of many years at hard labor on petitioner.

The Tax Court should have considered petitioner's exhibits and disposed of petitioner's argument that his factory rental activities amounted to a trade or business in addition to the trade or business carried on by his corporation. Instead the issue and the relevant exhibits were swept under the rug.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

LORENTZ W. HANSEN
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APPENDIX

APPENDIX A — SUMMARY ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DATED AND FILED JULY 9, 2001

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

SUMMARY ORDER

* * *

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 9 day of July, two thousand and one.

PRESENT: HON. DENNIS JACOBS,
HON. FRED I. PARKER,
HON. SONIA SOTOMAYOR,

Circuit Judges.

No. 00-4177

ALLEN C. CHAMBERLIN and
MARTHA L. CHAMBERLIN,

Petitioners-Appellants,

– v. –

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

* * *

Appendix A

Appeal from the United States Tax Court (Cohen, J.).

UPON DUE CONSIDERATION, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the judgment of the Tax Court be, and it hereby is, **AFFIRMED**.

This case principally involves a dispute over whether Petitioner Allen C. Chamberlin legitimately deducted from his income taxes business bad debts stemming from uncollectible loans he had made to two corporations in the early 1980s.* The United States Tax Court (Cohen, J.) ruled that Petitioner could claim a bad debt deduction, but less than Petitioner sought, and agreed with the Commissioner that the bad debt was "nonbusiness" in nature, thereby impairing its utility in the tax years at issue: 1985 through 1993. We affirm.

I.

Except as provided below, we assume familiarity with the facts of this case as set forth in the Tax Court's Memorandum Findings of Fact and Opinion. **[JA 4-34]** Petitioner, a doctor of orthopedic medicine, came to believe in the 1970s that the generic pharmaceutical industry was entering a period of strong, sustained growth. Seeking to capitalize on this opportunity, he invested heavily in two pharmaceutical companies in the early 1980s (he owned 85% of the stock in one of the companies and was Chairman of its Board). Much of his investment was in the form of unsecured loans. Both companies went bankrupt, as did

* Mrs. Chamberlin is a party only because the Chamberlins filed joint income tax returns.

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Petitioner, who had leveraged his personal holdings in an effort to preserve his investment. In the end, Petitioner lost more than $6 million.

Petitioner delayed income tax returns for most of the years at issue (tax years 1985-1993) until late 1994 or 1995. When he did file, he sought to carry forward into 1985 and later years the losses he sustained from the bankruptcy of companies with which he had been associated. The Commissioner rejected this theory, and proposed deficiencies of income taxes and penalties totaling some $436,000.

Petitioner timely petitioned the Tax Court for redetermination of the asserted deficiencies and penalties. Following a trial, the Tax Court entered a decision largely sustaining the Commissioner's determinations. On appeal, Petitioner challenges: (i) the Tax Court's ruling his bad debt losses nonbusiness variety; (ii) the amount of the nonbusiness bad debt deduction that the Tax Court allowed; (iii) the Tax Court's limitation on the amount of trial time afforded to Petitioner's case; and (iv) the Tax Court's finding that Petitioner was liable for failure to file and failure to pay penalties.

II.

1. *Nature of the Debt*

Petitioner argues that he was "engaged in a trade or business," and that he is therefore entitled to treat his losses as business losses. The question as to whether a debt is business or nonbusiness in nature "requires an examination

of the facts in each case," and is conclusive if "adequately supported by th[e] record." *Higgins v. Commissioner*, 312 U.S. 212, 217, 218 (1941). Accordingly, the Tax Court's determination of whether a debt is business or nonbusiness is reviewed for clear error. *See Morton v. Commissioner*, 174 F.2d 302, 303 (2d Cir. 1949) ("The Tax Court gave consideration to the evidence of intention but was convinced that [Petitioner] was not engaged in farming for profit. We cannot hold that finding to be clearly erroneous.").

The Tax Court's determination that Petitioner's losses were deductible only as nonbusiness bad debts was not clear error. Applying *Commissioner v. Groetzinger*, 480 U.S. 23 (1987) and *Whipple v. Commissioner*, 373 U.S. 193 (1963), the Tax Court correctly determined that Petitioner's losses were incurred in the course of his activities as an investor, not as a person "engaged in a trade or business." *Whipple*, 373 U.S. at 202-03. Petitioner's claim that he was a "promoter" of health care corporations is arguably undercut by his trial testimony that he anticipated reaping long-term gains from his pharmaceutical investments because he foresaw a rosy future for generic drugs. And Petitioner's claim that he controlled his pharmaceutical business as a landlord (thereby converting his nonbusiness shareholder losses into business debt) is inadequately supported by the record. Inasmuch as the record indicates that taxpayer used the Freedom Federal funds to purchase another pharmaceutical company, we conclude that the creation of the debt was dominantly motivated by his nonbusiness interest. *See United States v. Generes*, 405 U.S. 93, 101 (1972).

2. *Amount of Deduction*

Petitioner argues that the Tax Court erred in finding that he was entitled to a $450,000 nonbusiness loss deduction only. The Tax Court's findings of fact regarding the amount of a taxpayer's bad debt losses are reviewed for clear error. *See Delk v. Commissioner*, 113 F.3d 984, 986 (9th Cir. 1997); *Rapco, Inc. v. Commissioner*, 85 F.3d 950, 954 (2d Cir. 1996).

The Tax Court's finding that Petitioner's allowable nonbusiness losses are limited to $450,000 was not clear error. Petitioner's trial testimony regarding how he disbursed proceeds (apart from the $450,000 that he immediately paid back to the lender) of the $1.75 million Freedom Federal loan was vague and arguably contradictory, and the documentary evidence presented at trial did not establish entitlement to additional deductions.

3. *Insufficient Trial Time*

Petitioner argues that the Tax Court denied him adequate time to present his case.

The manner in which a judge conducts a trial is reviewed for abuse of discretion. *See Hansen v. Commissioner*, 820 F.2d 1464, 1467 (2d Cir. 1987). The Tax Court did not abuse its discretion in limiting the trial to one and one-half days. First, Petitioner has made no showing of what determinative evidence he was unable to introduce. Second, much of Petitioner's case was devoted to evidence purporting to establish a theft loss stemming from misrepresentations that induced Petitioner into investing in one of the bankrupt

corporations — evidence that had little or no impact on the amount of income taxes and penalties owed to the IRS.

4. *Penalties for Late Filing and Late Payment*

Petitioner argues that the Tax Court erred in affirming the Commissioner's imposition of an additional tax as a penalty for failing to timely file tax returns from 1985 through 1993. He points out that he was involved in three bankruptcy proceedings, one of them his own, that he was receiving advice from a certified public account, and that, accordingly, his failure was due to "reasonable cause and not due to willful neglect." 26 U.S.C. § 6651(a)(1). The Tax Court did not abuse its discretion in rejecting these excuses.

Failure to file a tax return on the date prescribed results in a mandatory penalty unless the taxpayer shows that the failure was due to reasonable cause and not willful neglect. *See id.*; *see also McMahan v. Commissioner*, 114 F.3d 366, 369 (2d Cir. 1997). Generally, factors that constitute "reasonable cause" include unavoidable postal delays, death or serious illness of the taxpayer or a member of his immediate family, or reliance on the mistaken legal opinion of a competent tax adviser, lawyer, or accountant that it was not necessary to file a return. *McMahan*, 114 F.3d at 369. Whether a factor constitutes "reasonable cause" for late filing under § 6651(a)(1) is reviewed de novo. Whether a factor is present in a particular case is reviewed for clear error. *Id.*

As noted by the Tax Court, Petitioner offered no evidence to show that his paid preparer was the cause of his failure to file federal income taxes in a timely manner. Moreover, the

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Tax Court appropriately relied on the fact that Petitioner is sufficiently educated to know (or should have known) that he was obliged to file taxes each year. *See United States v. Boyle*, 469 U.S. 241, 251 (1985) ("[O]ne does not have to be a tax expert to know that tax returns have fixed filing dates and that taxes must be paid when they are due.").

FOR THE COURT:
Roseann B. MacKechnie, Clerk of Court

BY: s/ Lucille Carr

APPENDIX B — MEMORANDUM FINDINGS OF FACT AND OPINION OF THE UNITED STATES TAX COURT DATED AND FILED FEBRUARY 11, 2000

T.C. Memo. 2000-50

UNITED STATES TAX COURT

Docket No. 1223-98.

ALLEN C. CHAMBERLIN AND
MARTHA L. CHAMBERLIN,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

Filed February 11, 2000.

* * *

MEMORANDUM FINDINGS OF FACT AND OPINION

COHEN, *Chief Judge*: Respondent determined the following deficiencies, additions to tax, and penalties with respect to petitioners' Federal income tax:

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		Additions to Tax and Penalties					
Year	Deficiency	Sec. 6653(a)(1)	Sec. 6653(a)(2)	Sec. 6653(a)(1)	Sec. 6653(a)(1)(A)	Sec. 6653(a)(1)(B)[1]	Sec. 6662(a)
1985	$ 0	$ 212	$ 192	$ 66	$ -	$ -	$ -
1986	6,282	2,991	1,573	-	827	5,282	-
1987	1,376	332	83	-	74	1,376	-
1988	2,921	774	961	172	-	-	-
1989	16,214	2,176	2,420	-	-	-	3,190
1990	41,339	11,067	12,081	-	-	-	8,132
1991	37,713	6,691	1,710	-	-	-	7,543
1992	49,979	9,940	1,354	-	-	-	9,994
1993	141,892	30,766	1,060	-	-	-	28,378

[1]50% of the interest due upon these amounts.

The issues for decision are: (1) The amount of losses sustained by petitioners from their investments in, loans made to, and loan guaranties for several pharmaceutical corporations between 1979 and 1984; (2) the years petitioners were entitled to recognize their losses; (3) whether the losses became part of the personal bankruptcy estate of petitioners; (4) the amount of carryover losses used by the personal bankruptcy estate of petitioners; (5) the character of any remaining losses; and (6) whether petitioners are liable for penalties and additions to tax for 1985 through 1993. Other issues in the statutory notice or in the petition have been abandoned by petitioners because they failed to present any evidence or argument concerning them.

Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

FINDINGS OF FACT

Some of the facts have been stipulated, and the stipulated facts are incorporated in our findings by this reference.

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At the time of the filing of their petition, petitioners resided in Greenwich, Connecticut. Allen C. Chamberlin (petitioner) is a doctor of orthopedic medicine, having graduated from the Boston University School of Medicine. Petitioners filed their joint Forms 1040, U.S. Individual Income Tax Return, for 1982 through 1993 on the following dates:

Year	Filing Date
1982	07/11/84
1983	09/06/94
1984	09/06/94
1985	09/17/88
1986	09/17/88
1987	09/17/88
1988	04/17/95
1989	04/04/95
1990	04/17/95
1991	03/27/95
1992	03/27/95
1993	10/16/95

The initial 1985, 1986, and 1987 Forms 1040 were blank and contained no financial information. Subsequently, on December 28, 1994, petitioners filed completed Forms 1040 for these years. Petitioners reported $1,324, $11,264, $98, $521, $1,584, $7,849, $9,499, $10,450, and $11,057 of total tax on their returns for 1985, 1986, 1987, 1988, 1989, 1990, 1991, 1992, and 1993, respectively. Petitioners prepared their returns with the help of a certified public accountant.

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Pharmacare, Inc. (Pharmacare), was a Delaware corporation engaged in the business of manufacturing unit dose pharmaceutical products and packaging cosmetic products and lotions. The main manufacturing facility for Pharmacare was located in Largo, Florida (Largo facility).

During 1978, Pharmacare was in serious financial difficulty and was looking for investors to provide working capital for the company. A group of investors led by Stelios Vavlitis (Vavlitis) agreed to invest funds in Pharmacare in exchange for a controlling interest in the outstanding stock of the corporation. Vavlitis planned to rebuild Pharmacare under his management and to attract other investors to provide working capital. Vavlitis created Pharmaco Trust, which bought an 87.6-percent interest in the outstanding stock of Pharmacare and held the acquired stock for management and sales purposes. Vavlitis was made president, chief executive officer, and chairman of the board of directors of Pharmacare.

In 1978, Vavlitis persuaded petitioner to purchase three units of Pharmaco Trust for $99,000. In doing so, Vavlitis made material false representations and misstatements about his prior business experience, his educational background, Pharmacare's ownership of patents, and the amount of competition that Pharmacare faced in the marketplace. In 1979 and 1980, Vavlitis also persuaded petitioner to make substantial unsecured loans to Pharmacare in order to keep the company running. Vavlitis failed to provide promissory notes for these loans despite repeated requests by petitioner.

On June 12, 1980, creditors of Pharmacare filed a chapter 7 involuntary bankruptcy petition against the company in the

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U.S. Bankruptcy Court for the Middle Division of Florida. As an unsecured creditor of Pharmacare, petitioner did not receive any payment from the Pharmacare bankruptcy to reimburse his investment or his loans. On their Form 1040, U.S. Individual Income Tax Return for 1982, petitioners deducted a loss from their Pharmacare investment and loans as a section 165 theft loss. Respondent audited the 1982 return and disallowed the loss.

On March 9, 1981, petitioner organized The Chamberlin Corporation (The Chamberlin Corp.), a Delaware corporation licensed to do business in Florida, for the purpose of continuing the Largo, Florida, operation. Petitioner became an 80-percent shareholder in The Chamberlin Corp., was elected chairman of the board of directors, and was hired as the chief executive officer. Petitioner did not receive a wage for the services he rendered in these positions. The Chamberlin Corp. purchased the inventory, intangible property, personal property, and equipment of Pharmacare from the trustee in bankruptcy for $200,000 and then immediately transferred ownership to petitioner. On September 18, 1981, in a three-party agreement, petitioner purchased the Largo facility from the Pharmacare trustee in bankruptcy by giving The Chamberlin Corp. a $183,800 promissory note and assuming $572,046 of debt secured by the property. The Chamberlin Corp. then paid $177,954 of Pharmacare debt on behalf of the trustee and $4,077 of transfer expenses. Petitioner rented the Largo facility back to The Chamberlin Corp. from 1981 until 1984.

On November 3, 1982, petitioner obtained a personal loan from the Freedom Federal Savings & Loan Association

(Freedom Federal) in the amount of $1,750,000. This loan was secured by a first mortgage on the principal residence of petitioners in Greenwich, Connecticut. Four hundred fifty thousand dollars of the loan proceeds was then reloaned by petitioner to The Chamberlin Corp. and used to pay off debts of The Chamberlin Corp. The Chamberlin Corp. also obtained loans from the Ingersoll-Rand Financial Corporation (Ingersoll-Rand) in the amount of $1,800,000, personally guaranteed by petitioner, and loans in the amounts of $750,000 and $250,000, secured by second mortgages on the Greenwich residence. Petitioner also personally guaranteed a loan of $300,000 from Ingersoll-Rand that was made to his incorporated medical practice.

In 1983, petitioner purchased Bel-Mar Laboratories (Bel-Mar), a company whose principal purpose was the manufacture of parenteral products. Parenteral describes liquid medication injected by syringe or needle directly into the bloodstream of a patient. Petitioner became the sole shareholder and chairman of the board of directors of Bel-Mar, and he immediately changed the name to Chamberlin Parenteral, Inc. (Chamberlin Parenteral).

In 1984, The Chamberlin Corp. was unable to pay its debts, and, on December 17, 1984, creditors filed an involuntary chapter 11 bankruptcy petition against the company. Petitioner continued to search for outside investments to save the company, and the company continued to operate at least through March 1985. The assets of The Chamberlin Corp., including the Largo facility that had been surrendered to the corporation by petitioner, were sold to pay debts of the company in June 1985.

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On July 11, 1985, petitioners filed a personal chapter 11 petition in bankruptcy. Petitioners did not make a section 1398(d)(2) election to terminate their taxable year on commencement of the bankruptcy. On the date of filing, debts of petitioners totaled $6,319,354, while their assets totaled $3,785,790. On August 15, 1985, the personal residence of petitioners was sold for $3,700,000 to satisfy creditor claims. This residence had been purchased by petitioners for $530,000. From the sale proceeds, the debt that was owed to Freedom Federal in the amount of $1,750,000 plus $550,000 in past due interest was paid in full. Ingersoll-Rand received $944,049 in partial satisfaction of its claims. The bankruptcy estate failed to file an estate tax return for 1985.

After filing their personal petition in bankruptcy, petitioners moved to California. All of their personal assets, which became the property of the bankruptcy estate, were placed in storage. Among these items were important business documents and tax records. Petitioners were unable to retrieve these documents because the bankruptcy estate failed to make the proper storage payments.

OPINION

Petitioners bear the burden of proving that the determinations in the notice of deficiency are erroneous and that they are entitled to any deductions claimed on their returns. See Rule 142(a); *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992); *Welch v. Helvering*, 290 U.S. 111, 115 (1933). A recurring problem for petitioners at trial was a failure to provide adequate supporting documentation and receipts to corroborate petitioner's testimony. The

unavailability of corroborating documents does not excuse a taxpayer's failure to carry the burden of proof. See *Malinowski v. Commissioner*, 71 T.C. 1120, 1124-1125 (1979).

Petitioners claim that they were the victims of theft at the hands of Vavlitis and, therefore, should be entitled to deduct their losses arising from their loans to and investment in Pharmacare as a section 165(c) theft loss. Petitioner also claims that he engaged in the trade or business of promoting pharmaceutical companies from 1978 to 1985 and, therefore, that he is entitled to deduct any losses arising from loans to or investment in Pharmacare, The Chamberlin Corp., and Chamberlin Parenteral as section 162(a) business expenses or section 166(a) business bad debts.

In coming to a decision on the issues in this case, it is necessary to calculate the amount of losses incurred by petitioners in years predating the tax years in issue. We do not have jurisdiction over years prior to 1985. See sec. 6214(b). However, the Court may consider events that occurred in prior years when such consideration is necessary to determine the tax liability for the years in issue. See *Lone Manor Farms, Inc. v. Commissioner*, 61 T.C. 436, 440 (1974), affd. without published opinion 510 F.2d 970 (3d Cir. 1975).

In the capacity of a creditor, a taxpayer realizes a loss from a loan made to a corporation that becomes worthless and uncollectible. The amount of loss from a worthless loan is the adjusted basis of the promissory note representing the debt. See sec. 166. The adjusted basis of a note equals the

face amount of the debt minus any principal paid back by the debtor corporation. See sec. 1.166-1, 1.1011-1, Income Tax Regs. Where a taxpayer borrows money from a third party and contributes or reloans the proceeds to a corporation, the taxpayer includes the proceeds transferred to the corporation in the basis of his stock in the corporation or in the promissory note representing the debt. The increase in basis occurs regardless of whether the taxpayer repays the third-party loan. See *Brenner v. Commissioner*, 62 T.C. 878, 883 (1974).

Amount of Losses

Petitioners claim to have suffered a loss in the amount of $1,255,400 from petitioner's dealings with Pharmacare. Respondent concedes that a loss was incurred by petitioners in the amount of $414,000 but contests the occurrence of the following transfers, which petitioners claim were loans made to Pharmacare:

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Loans	Date	Amount
Wire transfer	__/__/79	$ 25,000
Checks	10/19/79	10,000
	10/19/79	10,000
	10/19/79	10,000
	10/19/79	10,000
	10/19/79	10,000
	11/19/79	16,000
	11/21/79	49,500
	12/05/79	33,000
	12/12/79	45,000
Third-party	08/06/79	364,000
loan proceeds	08/23/79	35,000
	08/24/79	120,000
	09/12/79	40,000
	07/01/80	30,000
Miscellaneous	05/__/79	30,000
loans	06/__/79	3,900
Total		$841,400

Petitioners have provided five canceled checks endorsed to Pharmacare totaling $56,000. Petitioners have also provided evidence of third-party loans made to petitioner and Vavlitis jointly in the amounts of $364,000, $35,000, and $40,000. Petitioners have shown that the proceeds from these loans were contributed or reloaned to Pharmacare by petitioner and that the loans were repaid with property of petitioner. With respect to the remaining contested transactions, petitioners rely on a proof of claim filed in the Pharmacare bankruptcy and dated April 28, 1982. Under the

circumstances, we conclude that petitioners' minimal documents and testimony are sufficient to substantiate the amount of loss with respect to Pharmacare.

Petitioners also claim that they are entitled to recognize losses from petitioner's contributions to The Chamberlin Corp. and Chamberlin Parenteral. To substantiate their losses, petitioners have provided only a statement of net worth, prepared in 1982, that showed that petitioners' net worth was $6,032,052. They argue that their net worth fell to zero in 1985 as a result of The Chamberlin Corp. failure, and, therefore, they should be entitled to a loss of $6,032,052. Such a statement, uncorroborated by receipts, expenses, or other documentation that reflects how assets were lost or disposed of, is insufficient for determining the amount of losses sustained by petitioners. See *Henry Schwartz Corp. v. Commissioner*, 60 T.C. 728, 745-746 (1973). Thus, where petitioners have failed to provide any documentation to substantiate their loss, they have failed to carry their burden of proving entitlement to deductions.

Petitioners have provided documentation relating to a loan that was made from a third party to petitioner personally and loans that were made to The Chamberlin Corp., which were secured and satisfied by personal property of petitioner. First, petitioners argue that they are entitled to recognize $1,750,000 of loss stemming from a personal loan from Freedom Federal. Petitioner claims that he contributed or reloaned the entire amount of proceeds to The Chamberlin Corp. and Chamberlin Parenteral. Respondent argues that only $450,000 of the principal was reloaned to these corporations. Second, petitioners argue that they are entitled

to losses stemming from funds that petitioner contributed to The Chamberlin Corp., which were used for operating capital and the initial purchase of the Pharmacare assets in 1981.

Of the principal amount of the Freedom Federal loan, $450,000 was reloaned to The Chamberlin Corp. and used to repay a portion of a debt owed by The Chamberlin Corp. to E.F. Hutton Credit Corporation. Petitioner testified at trial that the remaining $1,300,000 of the Freedom Federal loan was used to purchase Bel-Mar, which later became Chamberlin Parenteral, and to provide working capital or to pay debts of The Chamberlin Corp. Petitioner also testified that he contributed all of the funds used by The Chamberlin Corp. to buy the assets of Pharmacare from the trustee in bankruptcy in 1981.

Petitioner has failed to provide sufficient evidence showing that the $1,300,000 of remaining principal was reloaned or contributed to either corporation or to show how much funding, if any, he provided to The Chamberlin Corp. for the asset purchases or startup costs. There is no contemporaneous corroboration of his generalized testimony. Therefore, petitioners' allowable losses from their contributions or reloans of the Freedom Federal loan proceeds to The Chamberlin Corp. or Chamberlin Parenteral are no more than $450,000.

The next argument of petitioners, which respondent does not contest, is that petitioners' bankruptcy estate is entitled to a loss of $944,049 for its partial repayment of loans made by Ingersoll-Rand to The Chamberlin Corp. The loans, which totaled $2,900,000, were repaid to the extent of $944,049 by

the bankruptcy estate of petitioners. A guarantor, such as petitioner, who pays part of a loan for a corporation in bankruptcy is deemed to have made a loan to the corporation for the amount paid to the creditor. The loan, deemed made to the corporation, is deductible as a worthless debt. See sec. 1.166-9, Income Tax Regs.

Timing of Losses of Petitioners

Petitioners argue that their $1,255,400 loss arising from Pharmacare should be recognizable in 1985, the year that the assets of The Chamberlin Corp. were sold in bankruptcy. This argument hinges upon a finding that The Chamberlin Corp. and Pharmacare should be regarded as the same entity. However, Pharmacare terminated and ceased to exist after the closing of its chapter 7 bankruptcy estate. The Chamberlin Corp. was a wholly separate organization that operated free and clear of Pharmacare's former debt, and any claims that petitioner had against Pharmacare were resolved with that corporation's bankruptcy discharge. The latest date when the loss would have been realized was 1982, the year petitioner filed his claim against the bankruptcy estate of Pharmacare. At that point, he had no realistic possibility of recovery. See *Morton v. Commissioner*, 38 B.T.A. 1270, 1278-1279 (1938), affd. 112 F.2d 320 (7th Cir. 1940); *Mack v. Commissioner*, T.C. Memo. 1995-482; sec. 1.165-1(d), Income Tax Regs. Therefore, the loss could only be used by petitioners as a section 172 net operating loss (NOL) carryover or capital loss carryover during the years in issue, depending on the character of the loss.

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The $450,000 loss, arising from the Freedom Federal loan proceeds, was realized by petitioner in 1985. A bad debt deduction is realized in the year it becomes worthless. See sec. 1.166-1(a), Income Tax Regs. The question of when a bad debt becomes worthless is a factual question based on all of the surrounding circumstances. Although bankruptcy is a strong indicator of when a debt becomes worthless, it is not an absolute rule that a loss becomes recognizable upon the filing of a petition in bankruptcy. See sec. 1.166-2, Income Tax Regs.

Creditors of The Chamberlin Corp. filed an involuntary petition in bankruptcy against the company on December 17, 1984. However, The Chamberlin Corp. continued to operate and sought outside investment in a quest to avoid involuntary bankruptcy until at least March 1985. Until the company accepted its involuntary bankruptcy fate in 1985, there was a reasonable possibility that the company could be saved and that petitioner could recover some or all of his $450,000 loan to The Chamberlin Corp. See *Morton v. Commissioner*, *supra* at 1278.

Personal Bankruptcy

Having decided the amount and timing of losses sustained by petitioners and the amount of losses sustained by their bankruptcy estate, the next issue for decision is the effect that petitioners' personal chapter 11 bankruptcy had on these losses.

Upon the filing of a voluntary chapter 11 petition in bankruptcy, certain tax attributes listed in section 1398(g)

become property of the bankruptcy estate and are no longer tax attributes of the taxpayer. Section 1398(g) reads as follows:

> SEC. 1398(g) Estate Succeeds to Tax Attributes of Debtor. — The estate shall succeed to and take into account the following items (determined as of the first day of the debtor's taxable year in which the case commences) of the debtor —
>
> (1) Net operating loss carryovers. — The net operating loss carryovers determined under section 172.
>
> (2) Charitable contributions carryovers. — The carryover of excess charitable contributions determined under section 170(d)(1).
>
> (3) Recovery of tax benefits items. — Any amount to which section 111 (relating to recovery of tax benefit items) applies.
>
> (4) Credit carryovers, etc. — The carryovers of any credit, and all other items which, but for the commencement of the case, would be required to be taken into account by the debtor with respect to any credit.

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(5) Capital loss carryovers. — The capital loss carryover determined under section 1212.

(6) Basis, holding period, and character of assets. — In the case of any assets acquired (other than by sale or exchange) by the estate from the debtor, the basis, holding period, and character it had in the hands of the debtor.

(7) Method of accounting. — The method of accounting used by the debtor.

(8) Other attributes. — Other tax attributes of the debtor, to the extent provided in regulations prescribed by the Secretary as necessary or appropriate to carry out the purposes of this section.

The bankruptcy estate uses any tax attribute received from the taxpayer plus its own attributes to reduce its taxable income. See sec. 1398(g). Certain tax attributes not used by the bankruptcy estate are returned to the taxpayer upon termination of the estate. See sec. 1398(i).

From 1982 until 1985, petitioners could not use any of their $1,255,400 carryover loss from Pharmacare to reduce taxable income. Under section 1398(g), the bankruptcy estate received the carryover loss from petitioners upon the filing of the bankruptcy petition. The bankruptcy estate of petitioners is also entitled to any loss arising from the

payment of $141,429 of interest, the amount of interest paid by the estate that was proportional to the $450,000 loan made to The Chamberlin Corp. from the Freedom Federal loan proceeds. Combined with the $944,049 worthless debt from the Ingersoll-Rand loan payment, the bankruptcy estate of petitioners had a combined loss of $2,340,878 available to reduce its taxable income beginning in 1985, the year the estate came into being.

The entire amount of loss is carried to the earliest taxable years to which such loss may be carried. See *Lone Manor Farms, Inc. v. Commissioner*, 61 T.C. at 441. The portion of such losses that is carried to other taxable years is the excess, if any, of the amount of loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. See *id.* Therefore, when a taxpayer claims carryover losses for the year in issue, it is necessary to determine whether the carryover losses, claimed as a deduction for that year, are still available or were absorbed as allowable deductions in prior taxable years. See *id.* A carryover loss deduction for a prior year, which would have been allowed if claimed, must be considered as actually having been allowed when determining the availability of a loss carryover to a subsequent year. See *id.*

The bankruptcy estate of petitioners did not file a tax return for 1985 and, therefore, did not use any allowable losses to offset taxable income in that year. During the later taxable years of the bankruptcy estate, 1986 to 1994, the bankruptcy estate filed tax returns but could not use any of the carryover losses to reduce its income.

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Petitioners have failed to produce the evidence necessary to calculate the taxable income of the bankruptcy estate for 1985, thus making it impossible to determine how much of the loss belonging to the bankruptcy estate was absorbed. Because we cannot determine whether any or all of the loss was absorbed by the bankruptcy estate, we conclude that petitioners have failed to prove that any amount thereof may be carried forward to the years in issue. However, even if we were to assume that the bankruptcy estate had no more income in 1985 than what the record before us reflects, the taxable income of the bankruptcy estate in 1985 would be more than enough to absorb completely $2,340,878 of deductible loss.

The bankruptcy trustee sold the personal residence of petitioners on August 20, 1985. The amount realized from the sale was equal to the $3,700,000 purchase price, and the adjusted basis was equal to the $530,000 cost basis. Although petitioner testified that he made several improvements to the property during his years of ownership that would adjust the basis upward, he presented no supporting receipts or documentation. Thus, the gain that was realized by the bankruptcy estate was equal to $3,170,000. See sec. 1001(a).

Petitioners argue that the estate should be allowed to use the $125,000 one-time exclusion of gain under section 121. However, we need not address the issue of whether the one-time exclusion is available for use by a bankruptcy estate because an election was not made by the estate under section 121(c). An election to use the one-time exclusion must be made prior to the expiration of the period for making a claim for refund of Federal income tax for the taxable year in which

the sale or exchange occurred. See sec. 1.121-4(a), Income Tax Regs. Any attempt by petitioners to make the election currently for the bankruptcy estate would be untimely.

The $3,170,000 of income from the sale of the personal residence in 1985 completely absorbs the $2,340,878 loss belonging to the bankruptcy estate. Thus, petitioners would have no carryover losses surviving the estate upon its termination to reduce petitioners' income during the years in issue. Having concluded that none of the losses belonging to the bankruptcy estate survived 1985, it is not necessary for us to determine their character.

Section 1398(g), however, prevents certain attributes from passing from a taxpayer to the bankruptcy estate. The $450,000 loss of funds borrowed from Freedom Federal and reloaned to The Chamberlin Corp., recognizable by petitioners in 1985, was a bad debt under section 166 at the time of the filing of the personal chapter 11 petition in bankruptcy. A section 166 deduction is not specifically mentioned in section 1398(g) as being an attribute that becomes part of the estate. Because petitioners did not make a section 1398(d)(2) election to split 1985 into 2 taxable years, the section 166 deduction did not become part of an NOL upon the filing of the petition in bankruptcy. Section 1398(g) thus preserves the section 166 deduction for the debtor. The $450,000 loss was recognizable by petitioners on their 1985 tax return, and any unused portion became a carryover NOL or capital loss belonging to petitioners and is available for use by petitioners as an offset of taxable income in later years.

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Character of the $450,000 Loss

Whether the $450,000 loss was a business bad debt under section 166(a)(1) or a nonbusiness bad debt under section 166(d)(2) depends on whether petitioner was engaged in a trade or business with respect to his endeavors with The Chamberlin Corp. See *Fincher v. Commissioner*, 105 T.C. 126, 136 (1995). A nonbusiness bad debt is deductible as a short-term capital loss, while a business debt is deductible as an ordinary loss. See sec. 166.

Petitioners contend that, from 1978 until 1984, petitioner was engaged in the trade or business of promoting business ventures in the health care industry. Respondent argues that petitioner's dominant motive for acquiring and guaranteeing loans for The Chamberlin Corp. was for investment purposes and that the activities of petitioner with regard to his promotion of business ventures do not rise to the level of a trade or business.

In order to be engaged in carrying on a trade or business, the taxpayer must be involved in the activity with continuity and regularity, and the taxpayer's primary purpose for engaging in the activity must be for income or profit. See *Commissioner v. Groetzinger*, 480 U.S. 23, 35 (1987). Activities that are sporadic do not qualify as a trade or business. See *Polakis v. Commissioner*, 91 T.C. 660, 670-672 (1988). The management of one's own investments is not considered a trade or business no matter how extensive or substantial the investment activities might be. See *King v. Commissioner*, 89 T.C. 445, 458 (1987). Resolution of this issue requires an examination of the facts of each case. See *Commissioner v. Groetzinger*, *supra* at 36.

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In *Whipple v. Commissioner*, 373 U.S. 193 (1963), the Supreme Court determined whether loans made by a shareholder to a corporation, in which he held a substantial interest, were deductible as business bad debts. In holding that the debts were not incurred in a trade or business of the taxpayer, the Supreme Court stated:

> Devoting one's time and energies to the affairs of a corporation is not of itself, and without more, a trade or business of the person so engaged. Though such activities may produce income, profit or gain in the form of dividends or enhancement in the value of an investment, this return is distinctive to the process of investing and is generated by the successful operation of the corporation's business as distinguished from the trade or business of the taxpayer himself. When the only return is that of an investor, the taxpayer has not satisfied his burden of demonstrating that he is engaged in a trade or business since investing is not a trade or business and the return to the taxpayer, though substantially the product of his services, legally arises not from his own trade or business but from that of the corporation. Even if the taxpayer demonstrates an independent trade or business of his own, care must be taken to distinguish bad debt losses arising from his own business and those actually arising from activities peculiar to an investor concerned with, and participating in, the conduct of the corporate business.

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> If full-time service to one corporation does not alone amount to a trade or business, which it does not, it is difficult to understand how the same service to many corporations would suffice. To be sure, the presence of more than one corporation might lend support to a finding that the taxpayer was engaged in a regular course of promoting corporations for a fee or commission, * * * or for a profit on their sale, * * * but in such cases there is compensation other than the normal investor's return, income received directly for his own services rather than indirectly through the corporate enterprise * * *.

Id. at 202-203. This Court has interpreted this language to mean that, in order for a taxpayer to be engaged in a trade or business of promoting business ventures, he must undertake such activity for compensation other than a normal investor's return. Such compensation must be in the form of a fee or commission or from the sale of the corporation for a profit in the ordinary course of business. See *Deely v. Commissioner*, 73 T.C. 1081, 1093 (1980), supplemented by T.C. Memo. 1981-229. Buying and selling businesses for profit can constitute a trade or business if the taxpayer shows that the entities were organized or acquired with the intent to make a quick and profitable sale after each business has become established, rather than with a view toward long-range investment gains. See *Id.*

In *Farrar v. Commissioner*, T.C. Memo. 1988-385, this Court found that a taxpayer was engaged in the trade or business of promoting business ventures. The taxpayer in

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Farrar bought and sold over 31 businesses, acquiring each one with the intent to bring in his own management staff, rebuild the company, and then sell it once the business became viable. Of the three businesses involved for which the taxpayer was claiming losses, the taxpayer had a plan aimed at earning a profit through the sale of the business.

In *Fleischaker v. Commissioner*, T.C. Memo. 1999-427, this Court found that a taxpayer was not engaged in the trade or business of promoting business ventures. In *Fleischaker*, the taxpayer guaranteed several loans made to an adult assisted-living center so that the corporation could build its facilities and cover operating expenses. The taxpayer based his investments on his belief that the demand for adult assisted-living centers would steadily increase due to the growing population of American senior citizens. The taxpayer intended to acquire interests in multiple adult assisted-living centers throughout the country and profit from his long-term stock ownership.

Petitioner has failed to show that he acquired his business ventures with an intent to sell them in the near future for profit. Instead, petitioner testified that he intended to build The Chamberlin Corp. into a much larger corporation and to hold the corporation for an extended amount of time. Petitioner testified that his motive for engaging in The Chamberlin Corp. venture was his belief that the demand for generic pharmaceuticals would steadily increase throughout the 1980's and that anyone positioned in the generic pharmaceutical market would stand to make a large sum of money. Petitioner was not paid compensation for his services to the corporation. His activities are more analogous

to those of an investor attempting to reap profits through dividends and the increase in value of his investment than to that of a promoter who buys and sells companies as if they were inventory. We conclude that petitioner was not in the trade or business of promoting business ventures in the health care industry. Thus, petitioners may not deduct as a business bad debt the $450,000 loss.

We have considered all other arguments of petitioners, and they are addressed by the consideration of lack of remaining carryover losses belonging to the bankruptcy estate or otherwise lack merit.

Additions to Tax and Penalties

Respondent determined additions to tax for failure to file tax returns under section 6651(a)(1) and additions to tax for failure to make timely payment of taxes under section 6651(a)(2). Respondent also determined additions to tax for negligence under section 6653(a)(1), additions to tax for negligence under section 6653(a)(1)(A) and (B), and accuracy-related penalties for negligence or substantial understatements under section 6662(a).

Additions to Tax for Failure To File Timely a Tax Return and Pay Tax Liability

Section 6651(a)(1) provides for an addition to tax of 5 percent of the tax required to be shown on the return for each month or fraction thereof for which there is a failure to file, not to exceed 25 percent. Section 6651(a)(2) provides for an addition to tax of 0.5 percent per month up to 25 percent for failure to pay the amount shown or required

to be shown on a return. A taxpayer may fail to file and pay a tax and thus be subject to both section 6651(a)(1) and (2). See sec. 6651(c)(1). If that occurs, the amount of the addition to tax under section 6651(a)(1) is reduced by the amount of the addition to tax under section 6651(a)(2) for any month to which an addition to tax applies under both paragraphs (1) and (2). The combined amounts under paragraphs (1) and (2) cannot exceed 5 percent per month. See sec. 6651(c)(1).

To escape the additions to tax for filing late returns, petitioners have the burden of proving that the failure to file did not result from willful neglect and that the failure was due to reasonable cause. See *United States v. Boyle*, 469 U.S. 241, 245 (1985). Reasonable cause requires taxpayers to demonstrate that they exercised "ordinary business care and prudence" but nevertheless were "unable to file the return within the prescribed time." Sec. 301.6651-1(c)(1), Proced. & Admin. Regs.

Petitioners argue that they used ordinary business care and prudence because they were acting at all times upon the advice of a certified public accountant who prepared their returns. Petitioners also claim that, due to their financial crisis at the time, any failure on their part to file returns or pay tax liability was unavoidable and excusable.

From 1982 to 1993, petitioners have shown a pattern of willful neglect in failing to file their Federal income tax returns in a timely manner. Although petitioners employed a paid tax preparer to prepare their returns, petitioners did not offer any evidence to show that the paid preparer was the cause of petitioners' failing to file and pay the tax shown on their returns on time. Also, petitioner is a well-educated

individual who knew or should have known that a tax return was due in a timely fashion during all of the years in issue. See *United States v. Boyle, supra* at 249-250.

Petitioners maintain that they lost some of their financial records when they placed them in storage in 1985. Although the loss of records was an involuntary action, it does not relieve petitioners of their duty to file a timely return. See *Zivnuska v. Commissioner*, 33 T.C. 226, 239-241 (1959). Therefore, we sustain the determinations of respondent with respect to the section 6651(a)(1) and (2) additions to tax.

Negligence Additions to Tax and Penalties

Respondent determined negligence additions to tax or penalties for all of the years in issue. For 1985, section 6653(a)(1) imposes an addition to tax equal to 5 percent of the underpayment if any part of the underpayment is attributable to negligence. For 1986 and 1987, section 6653(a)(1)(A) and (B) replaced former section 6653(a) but is similar in form. Section 6653(a)(1)(A) imposes an addition to tax equal to 5 percent of the underpayment if any part of the underpayment is attributable to negligence. Section 6653(a)(1)(B) imposes an addition to tax equal to 50 percent of the interest payable on the portion of the underpayment attributable to negligence. For 1988, Congress replaced former section 6653(a)(1)(A) and (B) with section 6653(a). Section 6653(a) was similar to former section 6653(a)(1)(A). Section 6653(a) imposes an addition to tax equal to 5 percent of the portion of the underpayment attributable to negligence. Section 6653(a)(1)(B), however, has no counterpart for 1988. For 1989, 1990, 1991, 1992, and 1993, section 6662 replaced former section 6653(a). Section 6662(a) and (b)(1) imposes

a penalty equal to 20 percent of the portion of the underpayment that is attributable to negligence or disregard of rules or regulations. For purposes of all of these provisions, negligence is defined as a lack of due care or failure to do what a reasonable or ordinarily prudent person would do under similar circumstances. See *Neely v. Commissioner*, 85 T.C. 934, 947 (1985).

For the years in issue, petitioners must show that they acted reasonably and prudently and exercised due care in reporting their taxes. See *id.* Petitioners assert that their actions were not negligent, and, therefore, they are not liable for additions to tax or penalties. They argue that they relied on the advice of a certified public accountant in calculating their tax liability during all years.

Taxpayers may satisfy their burden of proof as to negligence by showing that they reasonably relied on the advice of a competent professional adviser. See *United States v. Boyle*, *supra* at 250-251; *Freytag v. Commissioner*, 89 T.C. 849, 888 (1987), affd. 904 F.2d 1011 (5th Cir. 1990), affd. 501 U.S. 869 (1991). Reliance on professional advice, standing alone, is not an absolute defense but rather is a factor to be considered.

Although any reliance by petitioners on the advice of their paid preparer was unreasonable with respect to the failure to file a timely return, it was reasonable to rely on the advice of the paid preparer regarding the amount of tax liability to report during the years in issue. The facts of this case created genuine issues as to whether petitioners are entitled to use NOL carryovers on their returns for 1985 through 1993. Due to the complexity of the bankruptcy issues

involved, it was reasonable for petitioners to rely upon the incorrect advice of their paid preparer, who told them that they could deduct NOL's for their investments in and loans made to Pharmacare, The Chamberlin Corp., or Chamberlin Parenteral. Therefore, petitioners are not liable for negligence penalties from 1985 through 1993.

Substantial Understatement

Taxpayers are liable for penalties for substantial understatement of tax liability pursuant to section 6662(b)(2) if the understatement exceeds the greater of 10 percent of the correct tax or $5,000. See sec. 6662(d)(1)(A) and (B). The term "understatement" is defined as the excess of the amount of tax required to be shown on the return for the taxable year over the amount of tax shown on the return for the taxable year. Sec. 6662(d)(2)(A). An exception exists where the taxpayer has relied on invalid advice of a paid tax preparer if, under all circumstances, such reliance was reasonable and the taxpayer acted in good faith. See sec. 1.6662-4(g)(4), Income Tax Regs.

For the reasons previously discussed under the negligence analysis above, we conclude that petitioners' reliance on the tax liability calculated by their paid tax preparer was reasonable. Therefore, penalties for substantial understatement shall not apply.

To reflect the foregoing,

Decision will be entered under Rule 155.

APPENDIX C — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING PETITION FOR REHEARING DATED AND FILED OCTOBER 22, 2001

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
40 FOLEY SQUARE
NEW YORK, NY 10007

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 22 day of October Two Thousand One.

Present:

Hon. Dennis Jacobs,
Hon. Fred I. Parker,
Hon. Sonia Sotomayor,

Circuit Judges

00-4177

ALLEN C. CHAMBERLIN and
MARTHA L. CHAMBERLIN,

Petitioners – Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent – Appellee.

Appendix C

A petition for panel rehearing having been filed herein by Petitioners-Appellants Allen C. Chamberlin and Martha L. Chamberlin,

Upon consideration thereof, it is Ordered that said petition be and it hereby is **DENIED**.

FOR THE COURT
ROSEANN B. MACKECHNIE,
Clerk

By: s/ Arthur M. Heller,
Administrative Attorney

APPENDIX D — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING MOTION TO CORRECT DATED JANUARY 27, 2001

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

DOCKET NO. 00-4177

CHAMBERLIN

v.

CIR

* * *

ORDER

Before: Hon. Dennis Jacobs, Hon. F. I. Parker, Hon. Sonia Sotomayor, *Circuit Judges*

IT IS HEREBY ORDERED that the motion be and it hereby is DENIED.

FOR THE COURT,
ROSEANN B. MACKECHNIE,
Clerk
by

JAN 27 2001
Date

s/ Arthur M. Heller
Arthur M. Heller
Administrative Attorney

APPENDIX E — § 7458 OF THE INTERNAL REVENUE CODE OF 1986 (TITLE 26 UNITED STATES CODE)

§ 7458. Hearings

Notice and opportunity to be heard upon any proceeding instituted before the Tax Court shall be given to the taxpayer and the Secretary. If an opportunity to be heard upon the proceeding is given before a division of the Tax Court, neither the taxpayer nor the Secretary shall be entitled to notice and opportunity to be heard before the Tax Court upon review, except upon a specific order of the chief judge. Hearings before the Tax Court and its divisions shall be open to the public, and the testimony, and, if the Tax Court so requires, the argument, shall be stenographically reported. The Tax Court is authorized to contract (by renewal of contract or otherwise) for the reporting of such hearings, and in such contract to fix the terms and conditions under which transcripts will be supplied by the contractor to the Tax Court and to other persons and agencies.

* * * *

APPENDIX F — RULES 70(a)(1) AND 91 OF THE UNITED STATES TAX COURT RULES OF PRACTICE AND PROCEDURE

TITLE VII

DISCOVERY

RULE 70. GENERAL PROVISIONS

(a) General: (1) *Methods and Limitations of Discovery:* In conformity with these Rules, a party may obtain discovery by written interrogatories (Rule 71), by production of documents or things (Rules 72 and 73), by depositions upon consent of the parties (Rule 74), by depositions without consent of the parties in certain cases (Rule 75), or by depositions of expert witnesses (Rule 76). However, the Court expects the parties to attempt to attain the objectives of discovery through informal consultation or communication before utilizing the discovery procedures provided in these Rules. Discovery is not available under these Rules through depositions except to the limited extent provided in Rules 74, 75, and 76. See Rules 91(a) and 100 regarding relationship of discovery to stipulations.

* * *

RULE 91. STIPULATIONS FOR TRIAL

(a) Stipulations Required: (1) *General:* The parties are required to stipulate, to the fullest extent to which complete or qualified agreement can or fairly should be reached, all matters not privileged which are relevant to the pending case, regardless of whether such matters involve fact

or opinion or the application of law to fact. Included in matters required to be stipulated are all facts, all documents and papers or contents or aspects thereof, and all evidence which fairly should not be in dispute. Where the truth or authenticity of facts or evidence claimed to be relevant by one party is not disputed, an objection on the ground of materiality or relevance may be noted by any other party but is not to be regarded as just cause for refusal to stipulate. The requirement of stipulation applies under this Rule without regard to where the burden of proof may lie with respect to the matters involved. Documents or papers or other exhibits annexed to or filed with the stipulation shall be considered to be part of the stipulation.

(2) *Stipulations to Be Comprehensive:* The fact that any matter may have been obtained through discovery or requests for admission or through any other authorized procedure is not grounds for omitting such matter from the stipulation. Such other procedures should be regarded as aids to stipulation, and matter obtained through them which is within the scope of subparagraph (1), must be set forth comprehensively in the stipulation, in logical order in the context of all other provisions of the stipulation.

(b) Form: Stipulations required under this Rule shall be in writing, signed by the parties thereto or by their counsel, and shall observe the requirements of Rule 23 as to form and style of papers, except that the stipulation shall be filed with the Court in duplicate and only one set of exhibits shall

be required. Documents or other papers, which are the subject of stipulation in any respect and which the parties intend to place before the Court, shall be annexed to or filed with the stipulation. The stipulation shall be clear and concise. Separate items shall be stated in separate paragraphs, and shall be appropriately lettered or numbered. Exhibits attached to a stipulation shall be numbered serially, i.e., 1, 2, 3, etc. The exhibit number shall be followed by "P" if offered by the petitioner, e.g., 1-P; "R" if offered by the respondent, e.g., 2-R; or "J" if joint, e.g., 3-J.

(c) Filing: Executed stipulations prepared pursuant to this Rule, and related exhibits, shall be filed by the parties at or before commencement of the trial of the case, unless the Court in the particular case shall otherwise specify. A stipulation when filed need not be offered formally to be considered in evidence.

(d) Objections: Any objection to all or any part of a stipulation should be noted in the stipulation, but the Court will consider any objection to a stipulated matter made at the commencement of the trial or for good cause shown made during the trial.

(e) Binding Effect: A stipulation shall be treated, to the extent of its terms, as a conclusive admission by the parties to the stipulation, unless otherwise permitted by the Court or agreed upon by those parties. The Court will not permit a party to a stipulation to qualify, change, or contradict a stipulation in whole or in part, except that it may do so where justice requires. A stipulation and the admissions therein shall be binding and have effect only in the pending

case and not for any other purpose, and cannot be used against any of the parties thereto in any other case or proceeding.

(f) Noncompliance by a Party: (1) *Motion to Compel Stipulation:* If, after the date of issuance of trial notice in a case, a party has refused or failed to confer with an adversary with respect to entering into a stipulation in accordance with this Rule, or a party has refused or failed to make such a stipulation of any matter within the terms of this Rule, the party proposing to stipulate may, at a time not later than 45 days prior to the date set for call of the case from a trial calendar, file a motion with the Court for an order directing the delinquent party to show cause why the matters covered in the motion should not be deemed admitted for the purposes of the case. The motion shall (A) show with particularity and by separately numbered paragraphs each matter which is claimed for stipulation; (B) set forth in express language the specific stipulation which the moving party proposes with respect to each such matter and annex thereto or make available to the Court and the other parties each document or other paper as to which the moving party desires a stipulation; (C) set forth the sources, reasons, and basis for claiming, with respect to each such matter, that it should be stipulated; (D) show that opposing counsel or the other parties have had reasonable access to those sources or basis for stipulation and have been informed of the reasons for stipulation; and (E) show proof of service of a copy of the motion on opposing counsel or the other parties.

(2) *Procedure:* Upon the filing of such a motion, an order to show cause as moved shall be issued forthwith, unless the Court shall direct

otherwise. The order to show cause will be served by the Clerk, with a copy thereof sent to the moving party. Within 20 days of the service of the order to show cause, the party to whom the order is directed shall file a response with the Court, with proof of service of a copy thereof on opposing counsel or the other parties, showing why the matters set forth in the motion papers should not be deemed admitted for purposes of the pending case. The response shall list each matter involved on which there is no dispute, referring specifically to the numbered paragraphs in the motion to which the admissions relate. Where a matter is disputed only in part, the response shall show the part admitted and the part disputed. Where the responding party is willing to stipulate in whole or in part with respect to any matter in the motion by varying or qualifying a matter in the proposed stipulation, the response shall set forth the variance or qualification and the admission which the responding party is willing to make. Where the response claims that there is a dispute as to any matter in part or in whole, or where the response presents a variance or qualification with respect to any matter in the motion, the response shall show, the sources, reasons, and basis on which the responding party relies for that purpose. The Court, where it is found appropriate, may set the order to show cause for a hearing or conference at such time as the Court shall determine.

Appendix F

(3) *Failure of Response:* If no response is filed within the period specified with respect to any matter or portion thereof, or if the response is evasive or not fairly directed to the proposed stipulation or portion thereof, that matter or portion thereof will be deemed stipulated for purposes of the pending case, and an order will be issued accordingly.

(4) *Matters Considered:* Opposing claims of evidence will not be weighed under this Rule unless such evidence is patently incredible. Nor will a genuinely controverted or doubtful issue of fact be determined in advance of trial. The Court will determine whether a genuine dispute exists, or whether in the interests of justice a matter ought not be deemed stipulated.

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